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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates	)	WC Docket No. 03-228
	)	

COMMENTS OF THE VERIZON TELEPHONE AND LONG DISTANCE COMPANIES

Michael E. Glover
Edward Shakin
Joseph DiBella
VERIZON
1515 N. Courthouse Rd., Suite 500
Arlington, VA 22201
(703) 351-3099

John H. Harwood II
Lynn R. Charytan
Polly B. Smothergill
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, DC 20037-1420
(202) 663-6000

Counsel for the Verizon Telephone and Long Distance Companies

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INTRODUCTION AND SUMMARY

The operating, installation, and maintenance ("OI&M") restriction should be eliminated. It serves no purpose other than to impede the ability of the BOCs to compete effectively in the highly competitive broadband marketplace, and it imposes substantial costs that inhibit investment and innovation The concerns about discrimination and improper cost misallocation that originally caused the Commission to adopt this restriction in 1996 have been rendered moot by subsequent events. Changes in the price caps regime and adoption of the CALLS plan have eradicated any incentive to misallocate costs to regulated accounts, as any such misallocations would have no practical impact on rates for regulated services. At the same time, the development of competition in all segments of the market has made it difficult if not impossible for *any* carrier, including the BOCs, to raise prices for one service in the hopes of recovering the costs of another. The OI&M restriction is, in the words of Commissioner Martin, "overbroad" to address any possible remaining concerns; other proven and sufficient safeguards are already in place that prevent improper cost allocation and discrimination by a BOC and its section 272 affiliate. These safeguards have been applied effectively to other services that BOCs and their

272 affiliates share today, and historically have been sufficient to ensure fair competition by the BOCs in various market endeavors.

By contrast, the OI&M restriction imposes enormous inefficiencies on the BOCs, which interfere significantly with the BOCs' ability to undertake the enormous investment required for broadband deployment. The artificial distinctions imposed by the OI&M requirement similarly burden the BOCs' provision of streamlined broadband services today. Broadband offers providers and consumers the efficiencies of integrating all types of services; indeed, the availability of such efficiencies is one of the primary justifications for the enormous investment that will be necessary to build out a next generation, fiber-based broadband network. Yet the OI&M restriction deprives the BOCs of many of these efficiencies, and it adds costs to an already investment-intensive endeavor. To compete effectively in the provision of broadband services and to justify the significant investment risk involved in fiber deployment, BOCs must have the same ability as their more established cable and interexchange company competitors to offer coordinated, responsive service, including installation, maintenance, and repair.

The costs of the OI&M restriction are not only the inchoate loss of competition and innovation but also the huge expenditures the BOCs must make to comply with the unnecessary restriction. Verizon has already incurred hundreds of millions of dollars as a direct result of the OI&M restriction, and this amount will increase substantially over the next few years if the restriction is not eliminated. The other BOCs have incurred similar costs. These expenditures, standing alone, decidedly outweigh any perceived benefit of the OI&M rule.

The Commission already has an ample record demonstrating the substantial costs of the OI&M restriction and the effectiveness of other, directly applicable, existing safeguards. It thus may and should swiftly reach the correct conclusion here: the OI&M restriction should be promptly eliminated.[1/]

BACKGROUND

The Commission has long recognized that section 272 does not mandate total separation between the BOCs and their long distance affiliates.[2/] Instead, the purpose of section 272 is consonant with the overarching goal of the 1996 Act: to open all markets to increased competition by eliminating prior legal and regulatory restrictions, and to provide consumers with the benefits of integration across all markets and services. Thus, as the Commission said in adopting the *Non-Accounting Safeguards Order*,[3/]

> [w]ith the removal of legal, economic, and regulatory impediments to entry, providers of various telecommunications services will be able to enter each other's markets and provide various services in competition with one another. . . . As firms expand the scope of their existing operations to new product lines, they will increasingly offer consumers the ability to purchase local, intraLATA, and interLATA telecommunications services, as well as wireless, information, and other services, from a single provider (i.e., "one-stop shopping"), and other advantages of vertical integration.

1/ Pursuant to the Commission's invitation in the Notice of Proposed Rulemaking, *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, FCC 03-272 at 3-4, n. 17 (rel. Nov. 4, 2003) ("NPRM"), Verizon hereby attaches and incorporates all of its substantive filings in the OI&M forbearance proceeding. *See* Attachments 1- 22 hereto.

2/ Third Order on Reconsideration, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*; CC Docket No. 96-149 ¶ 18 (rel. Oct. 1, 1999) ("*Non-Accounting Safeguards Reconsideration Order*") ("[T]he term 'operate independently' does not require total structural separation.").

3/ First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, FCC 96-489, 11 FCC Rcd 21905, 21911 ¶ 7 (1996) ("*Non-Accounting Safeguards Order*").

Indeed, the Commission specifically noted in that order that integration of the services of a BOC and its section 272 affiliate could provide "economic benefits to consumers." *Non-Accounting Safeguards Reconsideration Order* at ¶ 18. The Commission accordingly understood its task in interpreting section 272 as permitting such competition-enhancing integration, while limiting opportunities for anticompetitive conduct during the initial years after a BOC obtained section 271 relief. *See, e.g., id.* ¶ 167.

The Commission attempted to reflect these twin goals in implementing the "operate independently" language in section 271(b)(1). Finding that section 272(b) does not "compel" the adoption of any "particular set of restrictions,"[4/] the Commission sought to fashion rules that "strike an appropriate balance between allowing the BOCs to achieve efficiencies within their corporate structures and protecting ratepayers against improper cost allocation and competitors against discrimination." *Non-Accounting Safeguards Order* 21986 at ¶ 167; *see also Non-Accounting Safeguards Reconsideration Order* ¶¶ 15-18.

In weighing those interests, the Commission expressly "decline[d] to read the 'operate independently' requirement to impose a prohibition on all shared services," holding that "the economic benefits to consumers from allowing a BOC and its 272 affiliate to derive the economies of scale and scope inherent in the integration of some services outweigh any potential for competitive harm created thereby."[5/] The Commission decided that in many respects this

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4/ *Non-Accounting Safeguards Reconsideration Order* ¶ 14. The Commission likewise found that "there is no 'precedent' in the Commission's rules that defines the term 'operate independently' as used in section 272(b)." *Id.* at ¶ 17.

5/ *Non-Accounting Safeguards Order* at 21986 ¶ 168; *see also Non-Accounting Safeguards Reconsideration Order* ¶ 15. In fact, the structure of section 272 confirms that Congress understood that BOCs and their 272 affiliates *would* share services: Congress provided that a BOC may not discriminate between its affiliate and other carriers with respect to the services balance tipped in favor of permitting sharing, such as the sharing of administrative and marketing services and joint research and development.[6] But the Commission decided to prohibit the sharing of resources between a BOC and its section 272 affiliate in the provision of OI&M services. 47 C.F.R. § 53.203(a)(2)-(3). The Commission concluded that this restriction was generally necessary to prevent opportunities for improper cost allocation and discrimination that would be costly to police through other safeguards. *Non-Accounting Safeguards Order* at 21984 ¶ 163. As we show below, that policy judgment must now be revisited and the restriction must be eliminated.

DISCUSSION

It is time to revisit the initial balance struck by the Commission in interpreting section 272(b)(1)'s "operate independently" language. Whatever the Commission's reasons for adopting the OI&M rules in 1996, the OI&M rule no longer is needed to safeguard against improper cost allocation or discrimination by the BOCs. Competition and price caps have eliminated any practical incentive to misallocate costs to regulated services. Further, applicable nondiscrimination safeguards, audits, and public disclosure requirements effectively preclude such conduct. Accordingly, the OI&M restriction today provides no benefits. By contrast, it imposes enormous costs, the most significant of which is to handicap the BOCs' ability to respond effectively to the needs of the broadband and enterprise markets, both of which require the integration and coordination that the OI&M rule precludes. The OI&M restriction requires duplication of OI&M functions that the 272 affiliate could have obtained from its BOC affiliate,

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(and goods) that it provides to its affiliate. *See* 47 C.F.R. §§ 272(c)(1), 272(e)(1); 272(e)(3); 272(e)(4).

[6] *Non-Accounting Safeguards Order* at 21986-87 ¶¶ 168-69; *see also* 47 C.F.R. § 53.203(a); *Non-Accounting Safeguards Reconsideration Order* ¶¶ 15, 18.

including functions such as professional services, operational support, back office provisioning, workforce and employee related expenses, and network operations.[7]

The Commission has regularly revisited separation requirements similar to the OI&M restriction to determine whether its initial analysis of the competing costs and benefits still holds.[8] The Commission thus can and should recognize that the regulatory and competitive developments that have taken place since the Commission adopted the OI&M rule in 1996 warrant a different outcome today. The Commission has "wide latitude" to change its policies to respond to "[t]echnological, commercial, and societal aspects of the . . . industry[.]" *Committee for Effective Cellular Rules v. FCC*, 53 F.3d 1309, 1317 (D.C. Cir. 1995) (citations omitted); *Harrington v. Chao*, 280 F.3d 50, 59 (1st Cir. 2002) ("[a]gencies . . . have leeway to change their interpretations of laws."). Indeed, the Commission *must* be free to respond to the public interest by modifying its rules. *DIRECTV, Inc. v. FCC,* 110 F.3d 816, 826 (D.C. Cir. 1997); *Florida Cellular Mobil Comm. Corp. v. FCC,* 28 F.3d 191, 196 (D.C. Cir. 1994).

Nothing about the OI&M rule or section 272(b)(1) itself limits the Commission's discretion in this regard. Commissioner Abernathy has concluded:

> There is little doubt that the OI&M restriction falls into the category of rules that are not "requirements" of the statute. When the Commission adopted the ban on

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[7] *See* Petition for Forbearance of Verizon, CC Docket No. 96-149 (filed Aug. 5, 2002) (attached hereto as Attach. 1). While the Commission's rules do not define the types of activities that constitute "OI&M," Verizon has applied the ordinary meaning of the terms "operating, installation, and maintenance" in determining the types of services that may not be shared between the Verizon local exchange carriers and their section 272 affiliates.

[8] In the *Computer Inquiries*, for example, the Commission remarked that it would "reexamine the public interest ramifications and regulatory implications" of structural separation if it received evidence of serious inefficiencies. Final Decision, *Amendment of Section 64.702 of the Commission's Rules and Regulations,* 77 F.C.C.2d 384 (1980) ("*Computer II*"); *see also* Report and Order, *Amendment of Sections 64.702 of the Commission's Rules and Regulations,* 104 F.C.C.2d 958, 964-965, ¶¶ 3-6 (1986) ("*Computer III*").

> sharing OI&M functions, it acknowledged that — unlike some of the other safeguards it was adopting — this rule was not compelled by the text of section 272.

Forbearance Order, Dissenting Statement of Commissioner Abernathy (emphasis added). Instead, as Commissioner Abernathy acknowledged, the rule was a "*policy* judgment." *Id.* (emphasis in original). The Commission has not only the discretion, but also the duty to revise that policy judgment today and to eliminate the OI&M rule, which is unnecessary and which disserves the public interest in a robust, competitive broadband market.

I. The OI&M Rule Is Not Necessary To Protect Against Any Risks of Discrimination or Cross Subsidization.

The OI&M rule is entirely unnecessary today. There now is no practical incentive *or* opportunity for BOCs to abuse OI&M sharing. Therefore, the Commission should have no concerns about the potential for anticompetitive BOC behavior upon the lifting of the OI&M sharing prohibition. And in any event, as Commissioner Abernathy has recognized, other "remaining safeguards appear adequate to prevent discrimination or other misconduct." *Forbearance Order*, Dissenting Statement of Commissioner Abernathy. Those safeguards, which effectively prevent improper cost allocation where the BOCs and their affiliates already share services, would achieve the same result in the absence of shared OI&M services. In sum, as Commissioner Martin said in concurring in the NPRM, there now is "sufficient evidence . . . to tentatively conclude that the operating, installation, and maintenance sharing prohibition is an overbroad means of preventing improper cost allocation or discrimination as required by the statute."[9] The prohibition on sharing OI&M services should therefore be eliminated.

A. Price Caps and Competition Have Eliminated Any Practical Incentive or Opportunity for BOCs To Misallocate Costs or Otherwise Engage in Anticompetitive Behavior.

Regulatory changes and competitive developments in all telecommunications markets have rendered obsolete the Commission's past concerns about OI&M sharing. To begin with, today there is no colorable incentive for BOCs to misallocate costs from OI&M services shared with their section 272 affiliates, because BOCs can gain no competitive advantage by doing so. When the Commission adopted the OI&M restriction, it noted that a carrier "may have an incentive" to misallocate costs *only if* it were subject to "rate-of-return regulation, a price caps structure with sharing . . . , a price caps scheme that adjusts the x-factor periodically based on changes in industry productivity, or if any revenues it is allowed to recover are based on costs recorded in regulated books of account . . . ." *Non-Accounting Safeguards Order* at 21912 ¶ 10.

None of these conditions applies today. As early as 1999, 36 states and the District of Columbia, as well as the Commission, already had substituted price caps for traditional cost-plus, rate base/rate of return regulation.[10] By breaking the link between the firms' overall profits and regulated rates, price caps eliminate the opportunity to recover costs or losses from any "monopoly" customers, thereby eliminating the regulated firms' incentive to cross-subsidize competitive services. State regulators and federal courts alike have recognized that price cap

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9/ Separate Statement of Commissioner Martin, Notice of Proposed Rulemaking, *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, FCC 03-272 (rel. Nov. 4, 2003) ("NPRM").

10/ *See State Telephone Regulation Report* (No. 7, Aug. 20, 1999, & No. 8, Sept. 3, 1999). Verizon's local telephone companies, for example, are regulated under price caps without a sharing mechanism in the federal jurisdiction and in the vast majority of states.

regulation is an effective safeguard against cross-subsidization and other anticompetitive behavior.[11]

Indeed, since it adopted the OI&M rule, the Commission has severed any remaining connection between price caps and costs by eliminating sharing from price caps and by adopting the CALLS plan (thus ending the need for a cost-supported SLC and linking the X-factor adjustment exclusively to the consumer price index). While AT&T has suggested that, when CALLS expires in 2005, the BOCs might advocate an increase in access charges based on costs that could be inflated by improper cost misallocation,[12] that idea is simply counterfactual. The BOCs, and Verizon's local telephone companies in particular, led the charge to move *away* from access charge regulation based on regulatory accounting costs. The idea that the BOCs might both reverse this stance *and* misallocate costs in anticipation of that day heaps unfounded speculation upon speculation.

In any event, competition has now removed any opportunity for BOCs — or any carriers — to cover the costs of one service by increasing the costs of another. In comparison to 1996, all market segments now are open to competitive entry, and there is no service that is immune

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11/ *See, e.g., United States v. Western Elec. Co.*, 993 F.2d 1572, 1580 (D.C. Cir. 1993) (price caps "reduce[] any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling."), *California v. FCC,* No. 92-70083 and Consolidated Cases, 39 F.3d 919, 926 (9th Cir. 1994) ("[T]he FCC has taken specific affirmative steps designed to deter and detect cross-subsidization by introducing price caps. . . . We conclude that with the implementation of these measures, . . . the BOCs' incentive and ability to cross-subsidize will be significantly reduced."); Massachusetts Department of Public Utilities, *NYNEX Price Cap*, D.P.U. 94-50 (May 12, 1995), p. 121 (price caps "insulate[] ratepayers from investment risk and subsidization of new ventures.").

12/ *See* Letter from Frank G. Simone, Government Affairs Director, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-149 at 4 (filed Sept. 16, 2003); Letter from Frank G. Simone, Government Affairs Director, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-149, at 7-8 (filed Oct. 1, 2003).

from inter- *or* intramodal competition. Indeed, as the Commission could hardly have anticipated in 1996, competition from CLECs and competitive access providers as well as wireless carriers, Voice Over IP, and cable telephony, has resulted in a continuing *decline* in demand for Verizon's local exchange and exchange access services. Verizon's local telephone companies have lost 12 million retail telephone lines in the last three years, and minutes of use for Verizon's local retail services declined by 7 percent in the last quarter. As the Commission previously has found, "competition is the most effective means of ensuring that charges [and] practices . . . are just and reasonable, and not unjustly or unreasonably discriminatory."[13/]

Finally, a BOC would gain no competitive advantage from either subsidizing its affiliate's OI&M costs or overcharging the affiliate by imputing *more* costs than necessary. If OI&M services were priced below cost, other competitors would procure those services at the same low rate pursuant to section 272(c), and the BOC would have to cover that cost several times over from local services that are -- as noted above -- already subject to extreme competitive pressures (and are often below cost to begin with). If the BOC provided its 272 affiliate with OI&M services at prices *above* cost, competitors would not use the service, and only the BOC's affiliate would bear these higher-than-necessary costs -- a serious disadvantage in the competitive long distance market.

B. Other Proven Safeguards Prevent Cost Misallocation and Discrimination.

The OI&M rule is unnecessary also because other, proven safeguards are already in place to prevent cost misallocation and discrimination by BOCs. There is no significant difference between the safeguards that would be required to monitor the sharing of OI&M services and

13/ Memorandum Opinion and Order, *Petition of US WEST Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance, et al.*, 4 FCC Rcd 16252, 16270, ¶ 31 (1999).

those applied to the administrative services that BOCs *already* may share with their section 272 affiliates.[14/] Four years of experience with the application of section 272 has shown that these other applicable regulatory safeguards are more than adequate to detect and prevent anticompetitive behavior by the BOC and its section 272 affiliate. More generally, the Commission for years has permitted the BOCs to integrate OI&M when they provide various other competitive services, without any detriment to competition.

In the absence of the OI&M restriction, the full panoply of section 272 safeguards that apply to other, currently shared services would apply to the sharing of OI&M services. *See Non-Accounting Safeguards Order* ¶¶ 180-82 (discussing safeguards that apply to shared in-house services, including section 272 provisions and affiliate transaction rules). For example, pursuant to section 272(b)(5), the BOCs' long distance affiliates would have to conduct OI&M transactions with the BOCs on an arm's-length basis, reduce them to writing, and make them

[14/] In its June 24, 2003 ex parte filing, Verizon described the minor changes that would be needed in the Cost Allocation Manual to account for the sharing of OI&M services. This would include the creation of new cost pools and the use of time reporting codes for technicians to use in assigning costs to the long distance affiliates. *See* Letter from Dee May, Assistant Vice President, Federal Regulatory, Verizon to Marlene H. Dortch, Secretary, FCC, WC Docket No. 02-33, CC Docket No. 96-149, Sub-attach. at 4-5 (filed June 24, 2003) (attached hereto as Attach.18).

available for public inspection.[15] Further, the separate affiliates would continue to be required to maintain separate books and be subject to audits.[16]

If the OI&M restriction were lifted, the BOC also would have to comply with the accounting and pricing restrictions contained in the affiliate transaction rules. 47 C.F.R. § 32.27. This requirement would avoid misallocation of costs to BOC operations and would result in allocation of all relevant costs to the 272 affiliates. Similarly, the nondiscrimination safeguards of sections 201, 202, 251(c), 272(c), and 272(e) of the Act would continue to apply.[17]

15/ "The separate affiliate . . . shall conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection." 47 U.S.C. § 272(b)(5). To satisfy the requirement that transactions be "reduced to writing and available for public inspection," the separate affiliate must provide a detailed written description of the transaction on the Internet within 10 days of the transaction through the company's home page; in addition, this information must be made available for public inspection at the BOC's headquarters. Report and Order, *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, 11 FCC Rcd 17539, 17593-94 ¶ 122 (1996).

16/ "The separate affiliate . . . shall maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [BOC] of which it is an affiliate." 47 U.S.C. § 272(b)(2). "A company required to operate a separate affiliate under this section shall obtain and pay for a joint Federal/State audit every 2 years conducted by an independent auditor to determine whether such company has complied with this section . . . ." 47 U.S.C. § 272(d).

Verizon has already conducted two biennial audits, which have revealed no material violations of the Commission's rules and demonstrate that Verizon has an effective system of internal controls for complying with section 272 rules.

17/ Section 201 would continue to require the BOCs to offer just and reasonable rates under the Commission's price cap rules. 47 U.S.C. § 201. Section 202 would continue to require the BOCs to provide exchange access services to affiliates and non-affiliates without unjust or unreasonable discrimination. 47 U.S.C. § 202. Section 251(c) would continue to require the BOCs to offer interconnection and unbundled network elements on a just, reasonable, and nondiscriminatory basis. 47 U.S.C. § 251(c). Section 272(c) would continue to require that BOCs provide to competitors the same OI&M services they provide to their 272 affiliates; section 272(e) would continue to require nondiscrimination in rates, intervals, and information about access services. 47 U.S.C. §§ 272(c), 272(e).

The Commission has ample authority to monitor and enforce all these rules and safeguards under sections 4(i), 220, 503, and 206-209 of the Act. And these rules have been more than adequate to prevent discrimination by the BOCs in favor of their section 272 affiliates to date with respect to the services that the BOCs are permitted to share with their affiliates.

In fact, as noted above, the Commission has long allowed the BOCs to compete in various markets, and to integrate OI&M services for their local exchange company services with new services, subject only to non-structural accounting and non-discrimination safeguards. The BOCs compete on an integrated basis in the intraLATA toll market, the interLATA corridor market, the information services market, the customer premises equipment market, and the inside wiring maintenance services market, and in each case are permitted to share OI&M services between these and their local exchange services.[18/] Yet in none of these markets have competitors' dire predictions of anticompetitive conduct come to pass. To the contrary, notwithstanding that in each case competitors theoretically rely on the BOCs' facilities in order to compete and reach the customer, the BOCs have not dominated any of these markets.[19/] Instead, nonstructural safeguards have proved sufficient to check discrimination and cost misallocation, and competition has flourished.[20/] There is no reason to believe that removing the

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18/ *See* Verizon Reply Comments, *Petition of Verizon for Forbearance From the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules,* CC Docket No. 96-149, FCC 03-271 (filed Sept. 24, 2002), Tardiff Decl. ¶¶ 9-12 (attached hereto as Attach. 2).

19/ In fact, the premise that competitors have no choice but to rely almost exclusively on the BOCs for essential inputs for their interexchange and other services is belied by the extensive and growing level of competition in the local exchange market. *See* Verizon Comments, *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements,* WC Docket No. 02-112 at 6-8 (filed Aug. 5, 2002).

20/ Incumbent LECs serve only about 45 percent of the intraLATA toll market. *See* Attach. 2 (Verizon Reply Comments, Tardiff Decl.) ¶¶ 8-11. Similarly, the BOCs have only a small

OI&M restriction from the section 272 rules would adversely affect interLATA long distance services competition when the absence of structural safeguards has had no such injurious effect in these other markets.

Not surprisingly, then, in opposing Verizon's OI&M forbearance petition, the incumbent interexchange carriers did not even seriously suggest that the sharing of OI&M services would lead to discrimination by the BOCs. Instead, they argued that competition would somehow be impeded because allowing the BOCs and their section 272 affiliates to share OI&M functions would position them to "meet customers' demands for service reliability and meeting deadlines" more effectively than most interexchange carriers allegedly could.[21] But that notion is simply backwards. If sharing permits BOCs to provide better service and achieve useful economies of scale, competition will increase, which will redound to the benefit of the consumers. The Commission has specifically recognized this. *Non-Accounting Safeguards Order* ¶ 7. Today, the interexchange carriers operate under a skewed market advantage to the extent that BOCs are required to assume the costs and other inefficiencies of structural separation, while their competitors may integrate their local and long distance operations. Correcting that by removing the OI&M restriction will merely obligate AT&T and other competitors to compete more vigorously to attract customers. That is hardly unfair.

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share of the information services market. In the voice messaging market, for example, the BOCs account for just over 15 percent of total annual revenues; similarly, there are hundreds of non-affiliated Internet service providers in the market. *See id.* ¶ 10. And the ILECs have only approximately 15 percent of the CPE and inside wiring market. *See id.*

[21] *See, e.g., AT&T Opposition to Verizon Petition for Forbearance,* CC Docket No. 96-149, Sept. 9, 2002, at 5.

II. The OI&M Prohibition Harms Competition in the Broadband and Enterprise Markets and Imposes Enormous Costs.

The OI&M restriction is not just unnecessary; it is affirmatively harmful to competition, especially in the broadband market. In a competitive marketplace, carriers must become increasingly efficient, streamlined, and innovative in order to retain customers and grow — and customers benefit when they do so. Yet the OI&M restriction works in the precise opposite direction. It imposes artificial and redundant costs, diverting dollars to the preservation of an artificial regulatory construct that instead should be spent investing in new broadband facilities and serving the customer. And since it handicaps only the BOCs, the rule skews the broadband market in favor of the cable incumbents and the so-called Big 3 interexchange carriers (AT&T, MCI, and Sprint) that already have the greater market share in residential and enterprise business broadband services, respectively. On top of that, the absolute costs imposed by the OI&M rule are enormous -- Verizon has incurred over **[BEGIN PROPRIETARY] [END PROPRIETARY]** in OI&M-related costs through 2002, and it will incur another nearly $300 million through 2006.[22]

As Commissioner Abernathy succinctly observed, "[t]he substantial costs imposed by the OI&M rule — including the need for duplicative resources — outweigh its benefits." *Forbearance Order*, Dissenting Statement of Commissioner Abernathy. In fact, the restriction provides *no* benefits today, only inefficiencies and costs. Again and again, the Commission has recognized that, where its separation rules lead to unnecessary duplicative costs and serious

[22] *See* June 4, 2003 Verizon Ex Parte, at Sub-attach. 4 (attached hereto as Attach. 16); Attach. 1 (Forbearance Petition), Howard Decl. at 3 ¶ 5. Assuming that section 272 sunsets for the last Verizon states in the first quarter of 2006, without OI&M relief, Verizon could not begin reducing these OI&M expenses until that time. Even then, the savings that could be achieved in the first year after the elimination of this restriction would be relatively low due to sunk investment and the cost of the administrative efforts that will be required to integrate the OI&M operations. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), at Sub-attach. 3, 4-5.

inefficiencies, elimination of the rule and resort to nonstructural separation is warranted. Well-established and consistent Commission precedent therefore supports elimination of the OI&M restriction.

A. The OI&M Restriction Interferes with Investment and Competition in the Broadband and Enterprise Markets.

The OI&M restriction imposes substantial costs on the BOCs — and only the BOCs — in the provision of integrated offerings of long-distance and local service. These costs significantly disadvantage the BOCs in providing broadband services, which combine all services — voice, data, and video — without regard to traditional distance-based distinctions.[23] Although the 1996 Act is designed to allow the BOCs, like *all* carriers, to participate in this market, the OI&M restriction singles out the BOCs for these artificial, regulation-based inefficiencies when they do so. Indeed, the OI&M construct treats such inefficiency as somehow desirable.

Specifically, as a result of the OI&M restriction, the Verizon local exchange companies and Verizon's interLATA network section 272 affiliate, Verizon Global Network Inc. (GNI),[24]

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[23] *See Communications Reports Record Breaking Revenue in Third Quarter as Sales of Data Services Expand*, Cambridge Telecom Report, Nov. 6, 2000, at 2, *available at* 2000 WL 100942333 (broadband services "blurring the lines between local and long distance and voice and data services. The result is that customers are now buying fully integrated communications services with the simplicity and quality they crave . . . that are extremely difficult for our competitors to truly match."); Leslie Brooks Suzukamo, *Telephone Users Face Confusing Array of Bundling, Other Cost Choices*, Saint Paul Pioneer Press, Jul. 13, 2003, at 1, *available at* 2003 WL 2617463 ("The line between your local phone company, your long distance provider, your cell phone and your Internet provider is blurring fast."); Dan Thanh Dang, *Phone Industry Turmoil Feared New Federal Rules Go Into Effect Tomorrow Number Portability Will Arrive Competition Is Expected, With Lively Consequences*, The Baltimore Sun, Nov. 23, 2003, at 4, *available at* 2003 WL 67729412 ("Experts predict that traditional phone providers will compete even more aggressively by offering to bundle a variety of services that could include broadband, local and long-distance calling, entertainment, and wireless access.").

[24] GNI operates Verizon's long distance network and serves Verizon section 272 carrier affiliates that are certified by the Commission and the respective state commissions.

must have distinct personnel and systems to provision and maintain the different local and long distance portions of any integrated service they seek to provide. This redundancy adds expense and inefficiency to the broadband services and networks that are otherwise designed to be efficient and streamlined. The OI&M restriction thus skews the economic incentives for BOCs to invest in fiber deployment and other next generation broadband facilities. In contrast, the incumbent interexchange carriers can use a single workforce to offer a "seamless" installation.

The OI&M rule also skews competition in broadband markets. The rule favors the cable and interexchange incumbents that already dominate the broadband and enterprise markets, while placing the BOCs, who are relative newcomers to both markets, at an artificial competitive disadvantage. Other providers are free from the costs and inefficiencies imposed by the OI&M rule. In the markets for both consumer and enterprise broadband services, the BOCs are already behind. Cable competitors dominate the broadband market, while the large interexchange carriers dominate the market for Frame and ATM services.[25] It makes no sense to burden only the newcomers to the market. This results in distorted competition and reinforcement of the cable and interexchange incumbents' existing market dominance.

The OI&M rule deprives consumers of efficiency in the broadband services they purchase today. Instead of spending funds on innovation and increased efficiency, the BOCs must focus their efforts on providing customers with a "combined" service package that appears integrated, notwithstanding that the provisioning of the local and long distance portions is not

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[25] *See* UNE Fact Report 2002, CC Docket Nos. 01-338 *(Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers)*; 96-98 *(Implementation of the Local Competition Provisions in the Telecommunications Act of 1996)*; 98-147 *(Deployment of Wireline Services Offering Advanced Telecommunications Capability)* (filed Apr. 12, 2002) at II-24 ("[T]he largest providers of both Frame Relay and ATM services are AT&T, WorldCom, and Sprint, which control more than two-thirds of the nationwide market for these services.").

integrated. For example, as Verizon develops new operation support systems for its fiber roll-out, absent a rule change, it will have to duplicate those systems to separately support local and long distance services.

Similarly, Verizon's long distance operations will take the initial call from the customer reporting a service problem, and then will notify the local operating company if it appears from the call that the trouble is on the local side of the network. If the local telephone operating company determines that the local network is not the root of the service problem, notification then must be passed to the 272 affiliate's repair personnel, who then must perform their own similar network verification.[26/] The response time to the customer could thus be significantly longer than it would be if one set of personnel could survey the network simultaneously. The only alternative is for the BOC to spend time and money identifying a means to ensure a sufficiently rapid response notwithstanding the regulatory barriers, thus diverting funds that could be used far more productively in the market.

As the Commission has recognized, the investment and risk involved in fiber deployment are enormous. *See Triennial Review Order* ¶ 274. Such investment is worthwhile only if broadband offers substantial improvement in speed, capacity, and overall efficiency. After repeatedly recognizing its obligation to *encourage* the development and deployment of broadband facilities, *see Triennial Review Order* ¶ 272, the Commission plainly should not continue to impose unnecessary regulatory obligations that increase costs and risks and provide no benefits to the consumer.[27/]

26/ *See* Attach. 1 (Petition for Forbearance of Verizon), McCully Decl. ¶ 6.

27/ Indeed, section 706(a) of the Act thus imposes an "affirmative obligation" on the Commission to revisit the OI&M rule. That provision requires the Commission to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to

B. The Costs of Complying with the OI&M Restriction Are Substantial.

When the Commission adopted the OI&M rule, it implicitly recognized that the rule must be justified by a "cost benefit analysis."[28] The Commission anticipated that such an analysis would in fact justify imposing the OI&M rule, because it perceived that the costs of monitoring the perceived opportunities for "improper cost allocation" through non-structural safeguards would involve "excessive, costly and burdensome regulatory involvement in the operations, plans and day-to-day activities of the carrier . . . to audit and monitor the accounting plans necessary for such sharing to take place." *Non-Accounting Safeguards Order* ¶ 163 (quoting the *BOC Separations Order* ¶ 71).

As demonstrated above, if there ever were significant risks of such cost misallocations, those risks have disappeared, and in any event, the costs of the non-structural safeguards that are in place have proved minimal. By contrast, the absolute costs imposed by the OI&M rule have proven to be enormous. The Commission's initial equation has been entirely reversed.

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all Americans . . . by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment." 47 U.S.C. § 157 note. Where there are less intrusive and burdensome means of safeguarding against any perceived risk of anticompetitive conduct, as there are here, the strong policies underlying section 706 mandate eliminating the burdens on broadband services and on enterprise services, which increasingly drive the development of advanced, sophisticated communications services.

[28] *See* Report and Order, *Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies; North American Telephone Association Petition for Declaratory Ruling on the Requirement for Sale of Customer Premises Equipment by the Bell Operating Companies*, 95 F.C.C.2d 1117 ¶ 71 (1983) ("*BOC Separations Order*") (cited in *Non-Accounting Safeguards Order* ¶ 163); *Non-Accounting Safeguards Order* at 21986 ¶ 167; *see also NPRM* ¶ 4 (noting that when the Commission adopted the OI&M restriction, it "recognized that restrictions on sharing of facilities and services imposes costs, including inefficiencies within the BOCs' corporate structures").

In addition to the manner in which it has encumbered service and diverted investment dollars, the OI&M rule has imposed millions of dollars in absolute costs on the BOCs. Verizon performed a cost study demonstrating that between 1998-2002, Verizon incurred **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** directly attributable to the OI&M restriction. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 4. In 2002, Verizon estimated that if the restriction were not eliminated, additional costs of $298 million would be incurred from 2003 through 2006. *See* Attach. 1 (Forbearance Petition), Howard Decl. at 3 ¶ 5. Verizon further estimated that if the OI&M restriction were eliminated, Verizon could avoid $183 million in OI&M-related costs over the next few years, even taking into account its sunk costs and the costs that GNI would pay to have the same work performed by Verizon's local exchange companies.[29] *See id.;* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 3 at 6.

For example, GNI would be able to rely on the Verizon local exchange companies' field technicians to perform most field work, such as installation and maintenance of facilities, rather than retaining outside contractors and third party vendors, as it does today. From 1998-2002, GNI incurred approximately **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** in connection with retaining contract employees and third parties to perform such work. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 4. The Verizon local exchange companies have large groups of field technicians who could readily perform this work for only a marginal price, consistent with Commission cost allocation and affiliate transaction rules, which

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[29] SBC similarly estimated that it incurs $77.8 million annually to comply with the OI&M restriction and that the bulk of these costs could be eliminated if the OI&M restriction were abolished. *See* SBC Communications Inc.'s Petition for Forbearance and Modification at 20 (June 5, 2003).

would substantially decrease the costs to GNI.[30/] Verizon estimates that, if the OI&M restriction were eliminated and Verizon could integrate the OI&M services of its local and long distance operations, GNI could save 95% of the total cost of work performed by outside contractors and third parties by 2005-2006. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 3 at 5.

Many of the costs attributable to GNI's error management and repair centers could similarly have been avoided by using BOC services. Verizon has estimated that GNI incurred approximately **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** in "back office" expenses between 1998-2002. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 4. If the OI&M restriction were eliminated, Verizon estimates that by 2005-2006, it could save 80% of its total "back office" costs by combining these tasks with those of the Verizon local exchange carriers. *See id.*, Sub-attach. 3 at 5. Eliminating the OI&M restriction also would free GNI from the obligation to maintain all of the capacities of its own network operations center, which provides monitoring and control of the long distance network. While GNI would continue to require some long-distance specific network operations, Verizon estimates that over **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** of the costs it has incurred in connection with the development of GNI's network operations center could have been avoided if Verizon's local exchange companies had been permitted to perform this work. *See id.*, Sub-attach. 4. And Verizon estimates that by 2005-2006, 30% of the ongoing costs of GNI's network operations center costs could be avoided by using the BOC network operations center to provide these functions. *See id.*, Sub-attach. 3 at 5.

[30/] Verizon's estimates do not assume that the local exchange companies have significant spare employee capacity, but rather that the local exchange companies' larger workforce could integrate GNI-related work into their current workloads at a lower incremental cost than GNI incurs.

More generally, if the OI&M restriction were eliminated, GNI could more efficiently deploy the employees it already has retained who now must perform OI&M functions. Much of GNI's OI&M work does not require a dedicated staff or specially trained employees. If GNI were not required to perform all its own OI&M work, it could deploy employees who currently perform OI&M to support other needs of the company, thus eliminating the need to hire more personnel to perform this other work. Between 1998-2002, Verizon incurred $53.5 million in connection with maintaining separate GNI employees as a result of the OI&M work; if these employees were freed up, Verizon estimates that it could save 30% of its total employee-related costs **[BEGIN PROPRIETARY]**

[END PROPRIETARY] by 2005-2006. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 4; *id.* Sub-attach. 3 at 5.

Finally, the OI&M restriction has caused GNI to incur significant expenses relating to the development and maintenance of its own operating support systems ("OSS"), which address inventory, provisioning, and order and trouble management. Instead of modifying the BOC systems and reusing them at a fraction of the costs, GNI was compelled to develop its own new systems. Between 1998-2002, GNI incurred nearly **[BEGIN PROPRIETARY]**

[END PROPRIETARY] in expenses relating to software and hardware maintenance, licenses and right-to-use fees, and non-capital software development, much of which could have been avoided if the OI&M restriction had not been in place. *See* Attach. 16 (June 4, 2003 Verizon Ex Parte), Sub-attach. 4. Because GNI has already made significant investment in developing and deploying OSS, including considerable software and hardware investments, OSS costs could not be entirely eliminated if the OI&M restriction were lifted, but GNI would at least be able to avoid OSS-related costs associated with software and hardware update purchases over future years. *See id.*, Sub-attach. 3 at 5, n. 4.

These enormous costs — and the substantial savings that could be realized if the OI&M restriction were eliminated — dwarf any benefits the rule could possibly provide above and beyond those available through applicable non-structural safeguards. While AT&T quibbled with Verizon's cost study in the forbearance proceeding, its various criticisms not only were unavailing — as outlined in detail in the incorporated pleadings from that proceeding[31/] — but also irrelevant. Even if Verizon's cost estimates were somehow reduced by as much as *half*, the resulting $90 million in costs that Verizon alone would incur — not to mention the costs for the three other BOCs — could not be justified in light of the far less expensive, equally effective means of achieving the same safeguards.

31/ *See generally* Attach. 2 (Reply Comments of Verizon); August 11, 2003 Verizon Ex Parte (attached hereto as Attach. 19); October 27, 2003 Verizon Ex Parte (attached hereto as Attach. 22).

CONCLUSION

For the reasons stated above, the Commission should eliminate the OI&M rule and should do so promptly.

Respectfully submitted,

John H. Harwood II
Lynn R. Charytan
Polly B. Smothergill
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, DC 20037-1420
(202) 663-6000

Counsel for the Verizon Telephone and Long Distance Companies

Michael E. Glover
Edward Shakin
Joseph DiBella
VERIZON
1515 N. Courthouse Rd., Suite 500
Arlington, VA 22201
(703) 351-3099

December 10, 2003

CERTIFICATE OF SERVICE

I, Mary Beth Caswell, do hereby certify that true and accurate copies of the foregoing, COMMENTS OF THE VERIZON TELEPHONE AND LONG DISTANCE COMPANIES, were served by hand delivery via courier this 10th day of December, 2003, to:

Chairman Michael K. Powell
Federal Communications Commission
445 12th Street, S.W., Room 8-B201
Washington, D.C. 20554

Commissioner Kathleen Q. Abernathy
Federal Communications Commission
445 12th Street, S.W., Room 8-B115
Washington, D.C. 20554

Commissioner Jonathan S. Adelstein
Federal Communications Commission
445 12th Street, S.W., Room 8C-302
Washington, D.C. 20554

Commissioner Michael J. Copps
Federal Communications Commission
445 12th Street, S.W., Room 8-A302
Washington, D.C. 20554

Commissioner Kevin J. Martin
Federal Communications Commission
445 12th Street, S.W., Room 8-C302
Washington, D.C. 20554

Janice M. Myles (2 copies)
Federal Communications Commission
Wireline Competition Bureau
Competition Policy Division
445 12th Street, SW, Suite 5-C327
Washington, D.C. 20554

William Maher, Chief
Wireline Competition Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5C-450
Washington, D.C. 20554

Qualex International
Portals II
445 12th Street, S.W., Room CY-B402
Washington, D.C. 20554

Mary Beth Caswell

Mary Beth Caswell